



# FINAL REPORT

## School Finance Formula Review Committee

December 2009

### MEMBERS:

Senator Brian Schoenjahn, Co-chairperson  
Senator Nancy Boettger  
Senator Robert Dvorsky  
Senator Paul McKinley  
Senator Becky Schmitz

Representative Roger Wendt, Co-chairperson  
Representative Cecil Dolecheck  
Representative Mike May  
Representative Sharon Steckman  
Representative Cindy Winckler

### Staff Contacts:

Amanda Knief, Legal Counsel,  
(515) 281-6048,  
[amanda.knief@legis.state.ia.us](mailto:amanda.knief@legis.state.ia.us)

Rick Nelson, Senior Legal  
Counsel, (515) 242-5822,  
[rick.nelson@legis.state.ia.us](mailto:rick.nelson@legis.state.ia.us)

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### AUTHORIZATION AND APPOINTMENT

The Legislative Council created the School Formula Finance Review Committee for the 2009 Legislative Interim pursuant to statutory law which requires a review of the school finance formula every five years. The charge of the Committee was as follows:

Prepare a school finance formula status report and provide recommendations in accordance with the requirements of Iowa Code § 257.1(4), including receiving assistance from the departments of Education, Management, and Revenue; providing recommendations for school finance formula changes or revisions based upon demographic changes, enrollment trends, and property tax valuation fluctuations observed during the preceding five-year interval; providing an analysis of the operation of the school finance formula during the preceding five-year interval; and incorporating a summary of issues that have arisen since the previous review and potential approaches for their resolution.

The Legislative Council authorized the Committee for one meeting, which was held on October 5, 2009.



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### I. October 5, 2009, Meeting

#### A. Overview

The primary focus of the Committee's meeting was an overview of the school finance formula and the changes that had occurred in the past five years since the first school finance formula committee meeting in 2004. Additionally, the Committee compared Iowa's school finance formula with other states and discussed future issues.

#### B. School Finance Formula

Mr. Jim Addy, Division of School Information and Support, Department of Education (DE), and Mr. Shawn Snyder, Fiscal Services Division, Legislative Services Agency, provided a comprehensive overview of the basic operation of Iowa's current school finance formula. From an organizational standpoint the overview consisted of an examination of the elements included within combined district cost; and a discussion of various funding sources, including school district revenue derived through the operation of the formula, a variety of levies facilitating local funding discretion, the statewide sales and use tax for school infrastructure, and state and federal categorical funding sources. With regard to the levies, Mr. Addy stated that they are generally intended to fund specified purposes or objectives, and that the DE anticipates proposing legislation during the 2010 Legislative Session which would allow consideration of making one-time exceptions to certain funding source requirements.

**Area Education Agencies.** Mr. Snyder provided a historical perspective about the development and evolution of area education agencies (AEAs) in the state, and discussed the flow-through nature of AEA funding and that AEAs do not possess independent taxing or spending authority. Previous and anticipated AEA mergers were identified, the three forms of AEA program services to local school districts were discussed, and charts and graphs depicting AEA funding by source and expenditures by function were supplied. Additionally, Mr. Snyder discussed the calculation of allowable growth and provided the highest and lowest ranges for district cost per pupil.

**Revenue Sources.** The basic "building block" revenue schematic involving the uniform levy, state aid, and the additional levy was presented, as were statewide dollar value totals for each. A financial breakdown of federal categorical aid was also presented, with the point emphasized that the totals are higher than in prior years based upon amounts received pursuant to the American Recovery and Reinvestment Act of 2009 (ARRA). The lack of continued federal stimulus money in future years was characterized as a "funding cliff," when the federal stimulus money is no longer available and would need to be replaced from state and local sources, and while all school districts have received their allocation of stimulus funding, not every district has expended it. It was noted that other sources of federal funding are received in the form of "Title Programs" and the website for tracking the receipt of such funding by school district was identified. The website is <http://www.iowa.gov/educate>; A to Z Resources; Allocations. Additionally, dollar value equivalents were supplied for combined district cost, the various levies, and the statewide sales and use tax for school infrastructure.



**Recent Iowa Enactments.** Mr. Snyder presented a historical overview of school finance law changes enacted during the preceding four legislative sessions. The changes included the ability of school districts with high property tax rates to qualify for additional property tax adjustment aid, the availability of property tax assessment appeal repayments under specified circumstances, increasing the duration for which English as a Second Language supplementary weighting can be received, increased supplementary weighting for designated sharing incentives, adjusted supplementary weighting for the Home School Assistance Program and community college courses and reauthorized weighting for regional academies, repeal of the local option sales tax for school infrastructure and replacement with a statewide sales and use tax, the inclusion ("roll-in") of certain state programs into categorical allowable growth, and adjustments in the form of across-the-board reductions and the ARRA.

### **C. Categorical Allowable Growth**

Mr. Snyder provided more in-depth information regarding the categorical allowable growth formula which began during the 2008 Legislative Session. He contrasted funding for the programs subject to the roll-in (educational excellence, early intervention/class size reduction, and student achievement teacher quality) prior to FY 2009-2010, which had been appropriations-based, with funding on a per-pupil basis but now are subject to an allowable growth calculation beginning in FY 2009-2010. Charts were presented detailing the impact of the program's fund roll-ins and the categorical allowable growth on per-pupil foundation levels and the budget guarantee, the categorical supplement allowable growth rate calculation procedure and amounts, estimated calculations for FY 2011-2012, and variances in cost-per-pupil amounts attributable to FY 2009-2010 funding being based on FY 2008-2009 allocation amounts.

### **D. Comparing Iowa's School Finance Formula With Other States**

Mr. John Myers, Augenblick, Palaich, and Associates, Inc., compared and contrasted the operation of Iowa's school finance formula with finance formulas from other states. Mr. Myers provided background information regarding his experience in school finance, indicating that he has visited 48 state legislatures about the subject, with particular emphasis on equity, adequacy, student achievement, and teacher quality issues. In placing Iowa's school finance formula within the context of other states, Mr. Myers employed a model formula which Iowa's formula emulates to a certain extent. He stated that there are currently 56 million students in kindergarten through grade 12 education nationally, attending 98,000 public schools across the country. Iowa has fewer than the national average of charter schools, spends less than the national average on teacher salaries, and has more school districts on average with a greater emphasis on local control. He noted that Iowa's supplementary weighting system for school district sharing services has been studied and adapted by other states.

**Iowa Comparison.** Iowa compares favorably regarding the extent to which allocation of state aid reflects differing school district needs, primarily through supplementary weighting and, until phased out, the budget guarantee. Iowa's state aid allocation is satisfactory, but an increase to 100 percent would better recognize each school district's fiscal capacities. In terms of recognition of student needs, Mr. Myers again cited supplementary weighting as a positive, but indicated that Iowa's special education weightings may cumulatively fall below average, and that at-risk funding



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definitely does. School districts in Iowa have an average amount of flexibility when compared with those in many other states, within the confines of their maximum spending authority, but a larger than average amount of local control which varies from a federally inspired national trend toward centralized standardization and control. With regard to state aid sensitivity to school district wealth or need, the 87.5 percent foundation base is fairly effective, but the variety of optional levies perpetuates a property tax rich versus poor district dynamic. Mr. Myers stated that some states allocate resources directly to school sites, which can result in less district-to-district variation, and that accountability through performance standards can be implemented to justify continued funding, albeit with a sacrifice in local control.

**Other Issues.** Mr. Myers discussed issues and projections relevant to school finance funding during the next five years. He echoed the characterization in an earlier presentation that the ARRA stimulus funding can be viewed as a "funding cliff," indicating that this fiscal year has constituted the lowest overall increase in kindergarten through grade 12 school district spending ever recorded, that the federal funding has in large measure been used to "backfill" reductions in school district budgets, and that some states have been reluctant to expend the funds for programs which will not be supportable in future years. Mr. Myers reiterated that Iowa should devote more attention to weighted funding directed to high-needs students and schools. He also addressed teacher compensation, emphasizing that teacher quality standards need improvement and that involving teachers as partners in the decision-making process yields positive results. Mr. Myers was critical of the state's abandonment of incentives for teacher performance and cited research supporting a direct link between money spent on teacher salaries and incentives and resulting student performance.

### **E. Property Tax Issues**

**Overview.** Mr. Snyder conducted a comprehensive review of the integration of property taxes into the school finance formula, and the issues and inequities which are inherent in a state aid and property tax mix. He began by providing a historical perspective dating back to the 1960s, noting that local property taxation was the basic funding mechanism through the 1960s, that state aid was introduced during the 1970s, that Iowa's current school finance formula was enacted in 1989 and applicable to the school budget year beginning in 1992, that property tax relief in the form of increased foundation percentages for the regular program and special education has occurred, and that the state sales and use tax for school infrastructure provides an additional funding element.

**Policy Issues.** Mr. Snyder listed the various components of the additional levy, summarized the operation of the Secure an Advanced Vision for Education and the Property Tax Equity and Relief components of the statewide sales and use tax for school infrastructure, and discussed the impact of tax increment financing (TIF) on school district property taxes. Mr. Snyder stated that levy rates increase as a result of the failure to include the TIF increment when calculating district property tax rates (other than the debt levy and physical plant and equipment levy), and that state aid required to backfill the uniform levy due to TIF totaled \$45.1 million for FY 2010. Finally, Mr. Snyder presented potential funding alternatives which could generate property tax relief, with the caveat that they were for illustrative purposes only and not to be considered recommendations by the Legislative Services Agency. The alternatives included expansion of the income surtax, with the



cautionary comment that fluctuating income tax revenue levels are observable particularly in recessionary periods; increasing the state foundation level; and changes in TIF diversion relative to levy rates.

### **F. School District Budget Issues**

**Fund Balances.** Ms. Lisa Oakley, Department of Management, and Ms. Su McCurdy, DE, discussed aspects of the school district budgeting process including ending balances, deficit spending, cash reserves, and the role of the School Budget Review Committee (SBRC). The definition and calculation of a school district's unspent authorized budget or unspent balance was reviewed, with the comment that the Department of Management's website can be used to access a listing of each school district's unspent balance. The unspent balance constitutes a school district's spending authority, in contrast to the district's ending fund balance or unexpended balance, which reflects the school district's ability to finance its spending authority. It was noted that if the unexpended balance is negative, the result is a financial condition comment in an audit, but that deficit spending is not disallowed by statute. Ms. Oakley presented a graph depicting general fund ending balances as a percentage of expenditures, with the average school district maintaining an unexpended balance of 11 percent of its authorized expenditures. With regard to negative fund balances, it was observed that school districts vary considerably regarding their comfort level in operating with a negative balance, with some districts placing a higher priority for lowering property taxes than for sound financial management. Negative balances can also be attributable to unanticipated expenditures occurring late in a school year, confusion on the part of a school district regarding unspent versus unexpended balances, certified and line item budgets exceeding the authorized budget, and accounting errors.

**School Budget Review Committee.** The role of the SBRC as a budgetary safety valve designed to counterbalance authorized budget limits and provide a measure of flexibility was discussed. The authority of the SBRC is limited to "unusual or unique" circumstances, and its assistance takes the form of modified allowable growth. It was noted that the SBRC serves in an advisory capacity with regard to school district negative fund balances, that such balances tend to track the economic condition of the state in general, and that school districts are required to submit corrective action plans for review by the DE.

Additionally, the rationale for levying for cash reserve, either to facilitate cash flow or to replenish such reserves to a specified level, was addressed. The SBRC's role with respect to cash reserve levies is to evaluate from a financial management perspective whether a levy can be considered excessive. Current and future statutory limits regarding cash reserve levy limits were highlighted, as was the impact of an across-the-board reduction in state appropriations on school districts. It was pointed out that such reductions reduce cash, but do not reduce a school district's spending authority, and that school districts will generally either expend cash on hand and levy for cash reserve to replenish it, or borrow in the event sufficient cash is not available and levy for cash reserve to repay borrowed funds.

### **G. School Finance Formula Review Committee Potential Recommendations**



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The following potential recommendations were contributed by Committee members at the conclusion of the meeting, pending additional consideration and final determination subsequent to the meeting:

- Conducting an in-depth study regarding the effectiveness of the school finance formula.
- Examining the sufficiency of all forms of supplementary weighting, including sharing incentives, at-risk, and special education.
- Conducting the review meetings more frequently than the statutorily mandated five-year interval.
- Recognizing that until the state's economic condition improves, Iowa may not be in a position to make any significant changes or improvements, and that there appear to be indications that from an equity standpoint some progress has been made.
- Exercising caution in formulating recommendations without sufficient information underlying them.
- Evaluating the merit of continuing to provide supplementary weighting for a three-year period during which school districts merely consider the possibility of consolidating or merging.
- Taking every opportunity for collaboration and maximizing utilization of existing resources.
- Mitigating the likelihood of increasing reliance on property taxes given the state funding shortfall, and including property taxation in any future studies relating to the school finance formula.

## II. Final Recommendations

Based upon the potential recommendations submitted for further consideration at the conclusion of the October 5, 2009, meeting, the following list of final recommendations was developed by the co-chairpersons following the meeting and distributed by e-mail to Committee members on November 19, 2009:

1. Conduct an in-depth study regarding the effectiveness of the school finance formula, including all forms of supplementary weighting.
2. Recognize that until the state's economic condition improves, Iowa may not be in a position to make any significant changes or improvements to the education finance formula.
3. Exercise caution in formulating recommendations without sufficient information underlying them.
4. Evaluate the merit of continuing to provide supplementary weighting for a three-year period during which school districts merely consider the possibility of consolidating or merging.
5. Take every opportunity for collaboration and maximizing utilization of existing resources, including consortiums and regional academies.



6. Recommend that the next school finance interim committee review various financing options for school transportation needs.

### **Proposed Additional Recommendations.**

As part of consideration of recommendations, Senator McKinley proposed three additional recommendations but the proposed recommendations did not receive sufficient support for inclusion with the final recommendations. The proposed recommendations are as follows:

1. The school aid formula should be designed in such a way to maximize student achievement at the most affordable cost possible, utilizing proven research techniques and methodologies.
2. There appears to be an underlying assumption that improvement in the formula means more money. In reality, it is not the amount of dollars that is important, but the manner in which the dollars are spent.
3. The goal of examining the school aid formula should not deal just with the amount of money spent, but in addition should include the very underlying principles that have resulted in Iowa student achievement remaining flat to declining relative to other states.

### **III. Materials Filed With the Legislative Services Agency**

The following materials listed were distributed in connection with the Committee and are filed with the Legislative Services Agency. The materials may be accessed from the "Additional Information" link on the Committee's Internet webpage:

<http://www.legis.state.ia.us/aspx/Committees/Committee.aspx?id=489>

1. Follow-up to Questions From the School Finance Formula Review Committee Meeting; Legislative Services Agency.
2. A Summary of Research and Resources Related to State School Funding Formulas; Midwest Regional Education Laboratory.
3. Comparing Iowa's School Finance Formula to Other States; Augenblick, Palaich, and Associates, Inc.
4. FY 2010 School Aid Weightings; Legislative Services Agency.



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5. How Do You Know a "Good" School Finance System When You See One?; Augenblick, Palaich, and Associates, Inc.
6. Income Surtax Alternative Example — FY 2010 Income Surtax Information by School District; Legislative Services Agency.
7. Increasing the Uniform Levy Rate and Foundation Level Percentage; Legislative Services Agency.
8. Instructional Support Program Funding; Legislative Services Agency.
9. Legal Background Briefing on Education Finance — Categorical Allowable Growth; Legislative Services Agency.
10. Legal Background Briefing on Education Finance — Regular Program Allowable Growth; Legislative Services Agency.
11. Legislative Guide — Basic Iowa Education Finance; Legislative Services Agency.
12. Letter From Iowa State Education Association President.
13. Letter From State Government Reorganization Interim Committee.
14. Memo and Attachments Regarding School Property Taxes by School District for FY 2010; Legislative Services Agency.
15. School District Budget Issues; Ms. Oakley, Department of Management, and Ms. McCurdy, Department of Education.
16. School Finance Formula Review Interim Committee — School District Property Taxes; Legislative Services Agency.
17. School Finance Formula Review Interim Committee — State Categorical Supplement School Aid Funding; Legislative Services Agency.
18. School Finance Overview in Iowa; Mr. Addy, Department of Education, and Mr. Snyder, Legislative Services Agency.
19. School Finance Overview in Iowa — Addendum; Mr. Addy, Department of Education, and Mr. Snyder, Legislative Services Agency.
20. Written Testimony From the Iowa Association of School Boards.
21. Written Testimony From the Sioux City Community School District.